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Sovereign Debt: A Guide for Economists and Practitioners*

Chapter 8 – The Restructuring Process**

Comments by Elena L. Daly***

1. Descriptive v. prescriptive. This chapter provides a masterly overview of the sovereign debt restructuring process as it is currently practiced. The authors have not, however, refrained from offering their views on how the process ought to function in several key areas (the role of creditor committees in sovereign debt workouts being just one example). I suspect that few people would defend the proposition that the international community has arrived at the optimal procedure for resolving sovereign debt problems. The views of leading experts on the question of how the process can be further improved are thus most welcome.

2. Creditor coordination. Even a quick perusal of this chapter leaves the reader with the distinct impression that one area in which modern sovereign debt restructuring techniques are almost wholly deficient is intercreditor coordination; not coordination *within* members of a creditor group (like commercial banks or bondholders), but rather coordination *between* different

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creditor groups such as commercial lenders, Paris Club bilateral creditors, non-Paris Club bilaterals, trade creditors, arbitration award holders and so forth. This chapter adequately covers the asymmetrical “Paris Club v. private sector” mechanism by which private sector lenders are expected to accept “comparable treatment” to that given to a debtor country by the Paris

3. Club, but the Paris Club vehemently resists any suggestion of a duty of “reverse comparability.” In this century, however, the most important challenge may well be how to coordinate *non*-Paris Club bilateral creditors like China or India into this process, as well as claimants that cannot be easily lumped into the traditional categories of banks or bondholders.

4. Holdout creditors. As the chapter makes clear, the idea that lenders to a sovereign debtor view themselves in an all-for-one/one-for-all fraternal relationship is increasingly quaint. Perhaps such a Band of Brothers spirit prevailed in the early 1980s among the commercial banks; it most assuredly no longer prevails. Most of the intellectual energy in this field over the last 25 years has been devoted to the search for restructuring techniques or legal doctrines that can suppress maverick creditor behavior -- the notorious “holdout” creditor problem that plagues all sovereign debt workouts. Sovereign debtors have attempted at various times over this period to find shelter from holdouts in legal doctrines such as sovereign immunity, champerty, act of state, comity, implied intercreditor duties and impermissible assignees. One by one, the courts have shut down or seriously curtailed these legal defenses. This was one of the principal legacies of the 15 years of litigation in New York courts by holdout creditors from Argentina’s debt restructuring. Attention has therefore shifted to contractual innovations such as collective action clauses. Indeed, the evolution of CACs in sovereign bonds since 2002 is a fascinating story of the international financial

community -- both sovereign debtors and their creditors -- inching their way toward a Chapter 11-style regime in which the supermajority of creditors can compel maverick colleagues to join a widely-accepted restructuring program. Depending on how you count, the market is now using Third or Fourth Generation CACs. This has been a Darwinian evolution. And it isn't over.

5. The human factor. There is sometimes a natural tendency to believe that because events in history turned out a certain way, they were *bound* to turn out that way no matter who may have been involved in the process at the relevant time. This is a fallacy. As the authors note in the second paragraph of this chapter, not all sovereign debt restructurings have had happy endings. Some failed because they took too long. Some failed because they secured insufficient debt relief to enable the country to regain its financial footing. Others failed because the debt relief they forced on creditors was seen as unnecessary and confiscatory. And others inflicted permanent bruises on the debtor country's reputation for honesty, efficiency and professionalism; sins that later had to be expiated in the form of higher borrowing costs. One cannot help but conclude that some of these failures might have been avoided had the individuals guiding the process been more knowledgeable, or more skilled, or more persuasive, or simply more respected by the official sector actors and the affected creditors. I finished reading this intriguing chapter with one lasting question: are we (the international financial community) doing enough to train a cadre of economists, policy-makers and lawyers in the exasperating but hugely consequential science/art of sovereign debt restructuring? This chapter, and the book in which it will appear, makes a significant contribution in that direction.

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